SCOPE AND FUNCTIONS OF THE STOCK MARKET

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With the development of large-scale machine production it was only natural that there should be a transition from the system of private partnership to that of corporate organization, depending for its financial existence and support on the sale of bonds and stocks. Through the corporate form of organization it became possible to combine the small savings of the thousands into huge sums, which could then be given a directing force by the great captains of finance and industry. The rate at which stocks and bonds have come to represent the wealth of the world during the past two decades has been so prodigious that our stock exchange markets may be said to represent the pulse of our economic life. As Mr. Charles Duguid so admirably says, in his work on "The Stock Exchange": "The institution may be defined as the nerve center of the politics and finances of nations, because in this market all that makes history is focused and finds instantaneous expression. It is worthy of being defined as the barometer of their prosperity and adversity, for a glance at the tone of this market, whose wares are more mercurial than those of any other mart, suffices to indicate their condition."

Numerous authors and statisticians have attempted to explain the relative importance of stocks and bonds in the world's wealth. Of these attempts that of Mr. Charles A. Conant deserves special mention. In an article on "The World's Wealth in Negotiable Securities," published in the "Atlantic Monthly" for January, 1908, Mr. Conant made a detailed examination of the subject, and while admitting that it is impossible to secure sufficient data to arrive at a conclusion with absolute precision, he found that the total visible outstanding securities issued by American corporations aggregated, on June 30, 1905, the enormous total of $34,514,351,382. Of this amount $21,023,392,955 represents the par value of stocks, and $13,490,958,427 the par value of bonds. These conclusions are within conservative limits, because, as Mr. Conant explains, his inves-

tigation did not permit the searching out of all small local corporations. Since 1905 the aggregate has been very materially increased, since as regards New York Stock Exchange securities alone there has been added from six hundred million to over one billion dollars worth of new securities annually. This enormous mass of securities is distributed over the various leading types of corporations as shown in the table on the next page.

Comparing this enormous total of American stocks and bonds with the total value of the country's physical property, placed by the Bureau of Census in 1904 at $107,104,192,410, it seems that securities represent nearly one-third of the nation's wealth. It is apparent, however, that a considerable proportion of these securities is owned by holding companies, which are themselves represented by securities. There is, thus, a duplication of the same capital, which must be eliminated in order to ascertain the proportion which security values bear to the total value of the country's wealth. Mr. Conant's figures show that such inter-corporate holdings of securities aggregated, in 1905, approximately $10,120,418,699, thus leaving the net par value of American stocks and bonds at $24,393,932,683, or approximately 23 per cent of the nation's wealth. These conclusions are not vitiated if we take into account the market value of such securities, because on June 30, 1905, the market value of the thirty-four billion dollars worth of securities amounted to nearly thirty-five and one-half billion dollars.

The Distribution of Stock Ownership

Quite as astonishing as the enormous amount of the country's wealth represented by stocks and bonds, is the wide distribution of ownership. In 1903 the author published an article on the distribution of stock holdings in American railways, in THE ANNALS of the American Academy, in which he showed that the number of persons who were direct owners of stock was very much larger than was generally supposed. Since that article was published the number of stockholders in American corporations has strikingly increased. Thus the "Journal of Commerce and Commercial Bulletin," recently collected official statistics for 110 of the largest corporations, with a total capital stock outstanding of $7,300,307,267. This investigation shows that the stock of these 110 corporations is owned by 626,984 stockholders, with an average holding of 116½ shares of the

PAR VALUE OF STOCKS AND BONDS OUTSTANDING JUNE 30, 1905.[1]

	Stocks.	Per cent of total.	Bonds.	Per cent of total.
(1) United States bonds	....	....	$895,158,340	6.64
(2) County and municipal bonds	....	....	2,141,437,283	15.87
(3) Steam railways	$6,554,557,051	31.18	6,024,449,023	44.66
(4) Street railways	1,761,571,812	8.38	1,455,520,159	10.79
(5) Banks	1,440,648,187	6.85	....	....
(6) Manufactures	5,522,774,073	26.27	1,274,347,290	9.45
(7) Mining, quarries and oil	2,982,835,544	14.19	314,883,914	2.33
(8) Telegraph and telephone companies	559,084,526	2.66	195,575,666	1.45
(9) All other corporations	2,201,921,762	10.47	1,189,586,752	8.81
Total	$21,023,392,955	100.00	$13,490,958,427	100.00

[1]Charles A. Conant's "World's Wealth in Negotiable Securities," *Atlantic Monthly*, Vol. 101, page 98. This table has been abbreviated.

par value of $100 each, or $11,650. The investigation further shows that in 1907, when quotations were unusually low, and when the public invaded Wall Street and found stocks upon the bargain counter, the total number of stockholders aggregated 639,836, with an average holding of 107⅞ shares, although the capitalization then only slightly exceeded $6,900,000,000.

The data offered by the "Journal of Commerce" becomes even more interesting if it be viewed separately for the railroads and industrials. Fifty-four out of the 110 corporations reporting are railroads. They showed a total outstanding capital of $4,157,008,136, owned by 288,160 stockholders, or an average of 5,336 stockholders for each company. During the preceding year, however, the capital stock, although aggregating only $3,875,000,000, was owned by 304,912 holders. The Pennsylvania Railroad, according to the "Journal's" figures, has 55,337 stockholders; the Atchison, 23,781; the Union Pacific, 19,075; the New Haven and Hartford, 16,311; New York Central, 16,292; the Great Northern, 14,307; the St. Paul, 12,475; the Southern Pacific, 11,238; the Southern Railway, 11,146; the Baltimore and Ohio, 10,610; and the Northern Pacific, 10,500.

In the case of industrials the "Journal of Commerce" furnishes data for fifty-six corporations, with a total outstanding capital of $3,143,299,131, and owned by 338,824 stockholders, or an average per corporation of 6,050. As compared with the railroads the industrials show a striking gain in the number of stockholders, there having been during the past year, for the 110 corporations under consideration, a decrease of 16,752 railroad stockholders, but an increase of 3,900 industrial stockholders. The American Telegraph and Telephone Company reports a gain during the last year of no fewer than 5,332 holders, the Westinghouse 4,486, Swift and Company 2,000, American Tobacco Company 868, and Borden's Condensed Milk 715. The United States Steel Corporation reports approximately 100,000 stock owners; the American Telegraph and Telephone Company, 31,702; the American Sugar Corporation, 18,517; the Western Union, 13,353; American Car and Foundry, 10,373; Swift and Company, 12,000; Pullman Company, 10,431; and the Westinghouse Company, 8,438.

The foregoing data becomes all the more important when it is remembered that the number of stockholders does not, in all cases,

represent individual holders, but in many cases includes corporations. One railway corporation may be the holder of a portion of the stock of another railway company, and may itself represent many stockholders. Or considerable blocks of such securities may be owned or held by trust companies, brokerage offices, life insurance companies, fire insurance companies, savings banks, and other investment companies, which in turn represent the investments or deposits of an enormous number of persons, many belonging to the middle and poorer classes. How far this process of subdivision must be carried in order accurately to determine the extent to which the population of the country is involved in the ownership of its corporate securities is difficult to judge. Suffice it to say that enormous blocks of securities are held in this way, and that this indirect form of investment is rapidly increasing.

More and more, also, there is a remarkable tendency for the investors of foreign countries, especially European, to enter foreign security markets in addition to their own. As has been well said, the security market is "undergoing the same internationalizing as commerce." In 1907-1908, British capital was invested in foreign securities to the extent of £2,693,738,000 and derived therefrom an income of £139,791,000, or $5^{20}/_{100}$ per cent. Over three billion dollars of British capital is invested at present in American railways, returning 125 million dollars annually in interest and dividends, to say nothing of the millions invested in our industrial and mining securities. The French holdings of foreign securities were estimated by M. Neymarck, as far back as 1900, to aggregate $6,240,000,000, and those of Germany were placed at $4,641,000,000, both of which figures have been greatly increased since that date.

The Stock Exchanges of the World

The enormous mass of corporate stocks and bonds, the wide distribution of their ownership among hundreds of thousands of persons of all classes, together with the increasing tendency to use such securities as collateral for loans, has necessitated the creation of a large number of stock exchanges in every important commercial country, where securities can be marketed with the greatest convenience and promptness. By far the majority of American and foreign security issues are quoted on organized stock exchanges,

and in many instances our leading corporations have their stocks and bonds listed, not only on several of the American stock exchanges, but also on the leading exchanges of foreign countries.

Stock exchanges may be of two kinds, either general, such as the London, New York, Paris and Berlin exchanges, where securities of all kinds are bought and sold; or special, such as the American exchanges at Salt Lake City and Colorado Springs, where only mining and a few local industrial stocks are listed. In a special market letter of March 8, 1910, Mr. Thomas Gibson has included a full list of those principal stock exchanges where all classes of securities are dealt in. To show how the world's stock exchanges have multiplied, because of the enormous increase of corporate securities, Mr. Gibson's list is given in full:

1. *United States*—New York, Boston, Philadelphia, Pittsburgh, Chicago, St. Louis, Kansas City, Denver, San Francisco, Los Angeles, Seattle, New Orleans and Baltimore.
2. *British Home Exchanges*—London, Birmingham, Liverpool, Manchester, Leeds, Bradford, Cardiff, Edinburgh, Glasgow and Dublin.
3. *British Empire*—In Canada: Montreal, Toronto and Vancouver. In Australia: Sydney, Melbourne, Adelaide, Perth, Kalgoorlie, Hobart, Lauceston, Ballarat, Newcastle, Brisbane, Maryborough and Charters Towers. In New Zealand: Christchurch, Wellington and Dunedin. In Straits Settlements: Singapore. In India: Calcutta, Bombay, Madras and Rangoon.
4. *Mexico*—Mexico City.
5. *South America*—In Argentina: Buenos Ayres. In Brazil: Rio de Janeiro and San Paulo. In Chili: Santiago and Valparaiso. In Peru: Lima. In Uruguay: Montevideo.
6. *Africa*—In Cape Colony: Cape Town and Port Elizabeth. In Egypt: Cairo and Alexandria. In Natal: Durban. In Transvaal: Johannesburg and Pretoria.
7. *Asia*—In Japan: Tokio and Yokahama. In China: Shanghai and Hong Kong.
8. *Europe (southern)*—In Austria: Vienna, Prague and Trieste. In Bulgaria: Sofia. In France: Paris, Lyons, Marseilles, Bordeaux and Lille. In Greece: Athens. In Italy: Milan, Genoa, Turin and Rome. In Hungary: Budapest. In

Portugal: Lisbon. In Roumania: Bucharest. In Spain: Madrid and Barcelona. In Servia: Belgrade. In Turkey: Constantinople.

9. *Europe (northern)*—In Belgium: Brussels and Antwerp. In Denmark: Copenhagen. In Germany: Berlin, Hamburg, Frankfort, Bremen, Breslau and Munich. In Holland: Amsterdam and Rotterdam. In Norway: Christiania. In Russia: St. Petersburg, Warsaw, Moscow and Odessa. In Sweden: Stockholm. In Switzerland: Geneva, Basle and Berne.

To an increasing extent capitalists are utilizing the services of foreign stock exchanges, since the investment field is no longer a local one, as formerly, but instead is being rapidly internationalized. "The modern systems of long distance telephony, telegraphy and cabling," as pointed out by Mr. Gibson, in his aforementioned letter, "have made it possible for investors to trade on any of the above-named stock markets at will." He goes on to say: "Investors living in London, Paris and New York have, of course, some advantage over those living in country towns. . . . Nevertheless, the affiliation of bankers, stock brokers, and arbitrageurs doing international businesses is so intimate that it is almost as easy for a resident of Carlisle, England, Reno, Nevada, or Florence, Italy, to deal in stocks on the Russian, Australian and Chinese stock exchanges as it is for them to trade on the stock exchanges in London, New York and Rome. British investors have had long experience in trading on foreign stock exchanges at long range, and German, Dutch and French investors are following their example at an increasing rate. This tendency of capitalists to look upon the whole world as an investment field, instead of the narrow limits of the locality in which they live, is rapidly increasing with the recognition of the theory of the geographical distribution of investment risks and is a factor in the development of international trade."

Functions of Stock Exchanges

According to the point of view, our large organized exchanges have been described by some as the political and financial nerve centers of nations and the barometers of national prosperity and adversity; and by others as "the bottomless pit, and as worse than all the hells." The latter description finds favor with people who view such markets solely from the standpoint of those who *foolishly*

or dishonestly abuse the facilities which are there afforded. The legitimate functions of every important branch of our business or political life are often shamefully abused or misused by fools or crooks, yet their mistakes or misdeeds do not disprove the utility of the institutions in question, but merely suggest a need for improvement and reform. Mr. Charles A. Conant, in speaking of the functions of stock exchanges, puts the matter well when he says:[2] "A moment's reflection might convince such persons that an institution which occupies so important a place in the mechanism of modern business must be a useful and necessary part of that mechanism; but reflection seems to have little part in the intellectual equipment of the assailants of organized markets. . . . The fact that the stock market is sometimes abused by people who go into it in a gambling spirit, who know nothing of its purposes and are incapable of understanding the mighty influences which dominate it, is no reason for considering it as a harmful excrescence on the body politic."

(1) In enumerating the services rendered by exchanges, chief importance must be given to the means they afford of readily transferring shares and bonds from hand to hand, an element which is vitally necessary to the creation of corporations. Without an organized market for corporate securities, the average individual holder would stand in a most defenseless position. He could not learn their price from day to day, because transactions, if private, would not be recorded, might be designed to mislead, and certainly would not be representative of the general judgment. He would be exposed to a hundred times the fraud of to-day. He would be at the mercy of every rumor. He would be unable to place a correct estimate of the importance of current events upon the price of his securities. He could be easily misled by unscrupulous counselors into selling his securities far below their fair value. Despite the many advantages of the limited liability company, it is also certain that most people would be loath to give their money for even the highest grade securities, if they had no positive assurance that in case of necessity they could, at a moment's notice, and at the prevailing price, obtain their value in cash by selling the same in the free market which our large exchanges afford.

To-day, however, every newspaper of any importance in the

[2] Charles A. Conant, "Wall Street and the Country." Pages 83 and 87.

country gives daily the quotations of leading securities for the day before, and the holder cannot be deceived as to the price. These quotations represent the average combined judgment of many minds, which is given concrete expression in actual transactions on the floor of the exchange. Through the widespread publicity of stock exchange quotations the world over, the holders of securities are given gratis the combined opinion of the most competent financiers as to the value of those securities at present and their prospective value in the future. Since these financiers always have in mind the future, rather than the present, their initiative in making purchases and sales will tend to discount the effects of coming events. The holder of stocks and bonds, if he be a thinking and observing man, is free to disregard these quotations if he chooses; but if their trend is pronounced they may serve as a guide by which he may regulate his own action relative to the holding or selling of his securities.

Importance must also be attached to the protection and safeguards which organized stock exchanges give the stock and bond holder, in regulating brokerage transactions and maintaining a standard of commercial honor among brokers, much higher than would otherwise exist. It is not to be wondered at that in the free buying and selling of such a vast amount of flexible and easily transferable property as corporate stocks, many questionable practices should have arisen, which only time will see eliminated. In this connection it should be remembered that the constitution of nearly every stock exchange defines the object of the exchange as follows: "Its object shall be to furnish exchanges, rooms and other facilities for the convenient transaction of business by its members, as brokers; to maintain high standards of commercial honor and integrity among its members, and to promote and inculcate just and equitable principles of trade and business." No person can be elected to membership until he has signed the constitution of the exchange, and by such signature he obligates himself to abide by the same, and by all subsequent amendments thereto. The value of this organization becomes apparent when we take account of the gigantic frauds perpetrated upon innocent investors through advertising campaigns by persons unaffiliated with any recognized exchange, or by certain members of unorganized curb markets.

While by no means perfect, the value of many of the stock

exchange regulations (nearly all stock exchanges have similar regulations) to the investing public are so evident that more than passing mention is unnecessary. Only a few such regulations will be noted.

All stock exchanges provide for the arbitration of disputes which may occur between members, and if both parties are willing, between members and their customers. They also prescribe rules governing the nature of contracts, the making of all offers and bids, the registry and transfer of securities on the transfer books of the corporations, and the conditions upon which securities may be listed upon the exchange for trading purposes. Practically all stock exchanges also require that all transactions must be real, and that no fictitious or unreal transactions shall be permitted; that discretionary orders cannot be accepted by brokers; and that every member of the exchange must keep complete accounts, subject at all times to examination by the governing committee or any standing or special committee of the exchange, and under penalty of suspension, no member may refuse or neglect to submit such accounts, or wilfully destroy the same. Nor may any member, under pain of suspension (a serious penalty involving not merely the loss of the rights and privileges of membership, but also the stigma attaching to the member as a factor in the business community) be guilty of "any conduct or proceeding inconsistent with just and equitable principles of trade."

Many exchanges stipulate that any broker employed for the purchase or sale of securities must keep a record of every transaction showing the date, number of shares, name of the security, price, the broker from whom bought or to whom sold, or for whom bought, or for whom sold; and on the day of executing the order, must furnish the customer with the name of the broker from whom the security was bought, or to whom sold. Non-compliance with this rule makes the broker guilty of fraud or false pretence, or of acts detrimental to the best interest of the exchange. Nor may any member sell securities for his own account, thus nullifying the effect of his client's order. Practically all exchanges provide that no member, under pain of suspension, shall be guilty of any act which the governing committee shall deem "detrimental to the interest or welfare of the exchange;" that no member shall resort to the publication of any advertisements, other than of a strictly legitimate

business character, any act to the contrary being deemed an act detrimental to the interest and welfare of the exchanges; and that no member may be connected, directly or indirectly, by any method whatsoever, with any bucket-shop or organization engaged in the business merely of dealing in differences of quotations on the fluctuations in the market, without a *bona fide* purchase or sale of the security or commodity involved.

According to a recent ruling of the New York Exchange, in order to prevent manipulation, and to protect the small investor or speculator, brokers offering to buy or sell more than 100 shares of stock, are compelled to accept any offering of 100 shares, or multiples thereof, and where an offer of a large block of stock is accepted, the buyer or seller must take care of the smaller offerings. If guilty of fraud, or fraudulent acts, or of having made a misstatement upon any material point in his application, either for membership or reinstatement, expulsion is the penalty. Here it should be said that the greatest care is taken by most exchanges in admitting new members, and that in order to be admitted, one must exhibit and prove his bank account and property holdings, and show that he has an adequate financial equipment. The exchanges also carefully regulate the branch offices of all members, and provide that no member shall form a partnership with a suspended member of the exchange, or with any insolvent person, or with anyone, formerly a member of the exchange, against whom any member may hold a claim arising out of transactions.

(2) The stock market also serves a most useful purpose in directing the flow of capital from channels where least needed into those where it can be most beneficially and profitably employed. Daily fluctuations in security prices may have but little significance, yet it is an axiom of the financial world that pronounced changes in the earning power of corporations are reflected, in the long run, by pronounced changes in the prices of their securities. It is equally true that if the stocks and bonds in a given line of industry are quoted, day after day, at a relatively low level, it is an indication of the unprofitable character of that type of investment. It soon ceases to be attractive to investors. The quotation table proclaims its unworthy character to the owners of capital more effectively than any other argument. New enterprises along the same line will be discouraged, for what reason is there to undertake the

extension of an industry already unprofitable, when the same quotation table indicates other lines of industry whose high and rising prices of shares, as a result of large and increasing returns, will serve as a guide to capitalists in directing the flow of their uninvested funds? If the shares of copper mines or street railways are low, and show an unfavorable movement, it is a warning to the holders of capital that they should exercise the greatest caution in giving financial support to the promotion and extension of these enterprises. If, on the other hand, the stocks of equipment companies, steel companies, or railroads are selling high, and show a rising tendency, it is an index that further development and increased production are desirable, and that the flow of capital into these channels is warranted.

By thus reducing the productivity or unprofitableness of many groups of industries to a common basis, and presenting the same in a table of quotations which is easily understood and accessible to all the world, our stock exchanges prevent the great misdirection of investments into unnecessary ventures, which would otherwise be the case. The stock exchange is the clearing house for all news of business significance. All information, political and industrial, is there studied and weighed by experts, who, by buying and selling, gratuitously give their conclusions to the world in the recorded quotations. These recorded transactions, representing the judgment of many trained minds, relieve the army of small investors of the trouble and expense, even provided this were possible, of familiarizing themselves with the many isolated facts underlying the operation, management and future prospects of corporations, possibly situated many thousands of miles away. "Through the publicity of knowledge and prices, the bringing of a multitude of fallible judgments upon this common ground, to an average, there is afforded to capital throughout the world an almost unfailing index of the course in which new production should be directed.[3]

It is more and more true that, just as the banks represent the organization of capital for the making of loans, so the great stock exchanges in America, England and Continental Europe represent the organization of capital for the purpose of investment. Their members and affiliated firms are most intimately associated with the largest banks, insurance companies, corporation directors, promoters

[3]Charles A. Conant, "Wall Street and the Country." Page 92.

and private capitalists. So intimate has this association become that, directly, or indirectly, the promoter with a scheme to develop, the inventor with an invention to finance, or the government and corporation with a large issue of securities to float—all hie themselves to large banking and brokerage houses which have stock exchange affiliations, and which are able to gauge the possibilities and success of the project, formulate the financial scheme by which the capital is to be raised, and lay it properly before the investing public.

(3) Not only does the stock market afford a valuable protection to the holder of securities and direct the flow of capital, but it also serves a most useful purpose to all business men by "discounting the future" and thus affording a register of prospective values for property other than that listed on the exchanges. It is this discounting process which has given our stock exchange the appellation of "barometer of future business conditions." As pointed out in other papers of this volume, speculation deals with the future and not the present or the past. The stocks and bonds of our corporations aggregate so large a proportion of the world's wealth, and represent such a variety of industries, that a marked rise or decline in the general level of prices is the surest indication, in fact an almost unfailing index, of coming prosperity or depression. And the all important fact is, that such changes of prices on the exchanges always precede, that is to say, discount the event, and do not follow, or occur concurrently. Without an exception every business depression in this country had been discounted in our security markets from six months to two years before the depression became a reality.

The financial and business panic of 1907 serves as the latest illustration of the significant fact. The business conditions of 1906 were the best that this country has ever enjoyed. Mills were running overtime, railroads were congested with traffic, and real estate operations were booming. The press was filled with the most roseate "write-ups" and predictions, yet despite the good news security prices showed little gain following the month of August. The earmarks of coming financial and business distress were at hand. The stock market was serving its purpose as the pivotal point where thousands of the brainiest men of the world were acting on judgments which had reference to the future and not the present.

Stocks were for sale by those who reasoned correctly and knew, and were purchased by those who did not know so much. They were even sold at a sacrifice, and as knowledge of the coming state of business affairs percolated from one strata of investors to another, the selling movement became more violent, and in March of 1907 we had our first stock exchange panic. A rebound in prices occurred, but stocks were still for sale, and in July we had our second panic. In the meantime, however, business was excellent, and the press of nearly the whole country wondered what all the trouble was about, and why the Wall Street gamblers were thus losing their senses. The business depression, however, followed, and when it was a reality to even the most ignorant, the stock market had clearly discounted the event, and prices of securities refused to yield further. When business was at its worst, complaints the loudest, and the public press blue as indigo, stock market prices were again merrily ascending. The exchange was again the pivotal point where thousands of the best minds of the country were expressing their judgment of the future, and were willing to convert their cash into securities, because of the anticipated increase in value.

It is the failure to understand this fundamental law of price movements which has been the cause of enormous losses to the unthinking and unknowing, whose judgments are based on what is seen and heard at the time. When the good news, whether it be big crops or large earnings, becomes common property, it has been discounted by the stock market; and similarly, when the bad news is apparent to all, it has likewise been discounted. It is only natural, therefore, that the rank and file should regard the stock market as a most incomprehensible affair, "a bottomless pit," always going contrary to what is so perfectly evident at the time. But one should remember that the stock market is not distinct from other markets. The manufacturer, the merchant, the produce dealer and the real estate operator, all have an interest in its fluctuations, since they have an important bearing on their own transactions. Many of the stock market fluctuations, especially those of a few days or weeks, have little significance, since they may represent only some particular local cause or the whim of some speculator. But if the market steadily and rapidly declines, many business men, who know its "discounting" significance,

will assume a waiting attitude as regards their planned undertakings, or curtail their production; and this waiting attitude, since all business is closely interrelated, will react upon all other forms of business effort.

In this connection attention should be called to the operations of the so-called "bears" who speculate for the fall of stocks through the process of selling "short" that which they do not possess with the object of buying back later at a lower price, and fulfilling delivery on their contract. Many condemn and few sympathize with the "bear" in the market, because of the belief that it is wrong to sell that which one does not possess, that no economic good is performed by this practice, and that "short selling" artificially depresses security prices. In fact many have recently strongly urged the prohibition of such sales.

A moment's reflection, however, will show that all these conclusions have little basis in fact. These critics forget that "short" selling is a common practice in practically all kinds of business. The manufacturer is expected by the wholesaler to sell his finished wares at a definite price for some definite future delivery, and to insure the delivery of his goods at a stipulated price and time, the manufacturer expects the commission man or produce broker to sell the raw cotton or grain or metal for future delivery at a definite price, long before the crop has been harvested or the metal obtained. Contractors, likewise, in contracting for work at a definite price, are constantly selling labor and materials short. The general practice of "hedging" on our exchanges, resorted to by nearly all business men handling our important staples, must necessarily involve a short sale. In business generally, "short selling" is regarded as a necessary means of insurance against business or speculative losses. If recognized here by all persons who have an understanding of business methods, it certainly cannot be maintained that it is wrong in the stock market to sell something which one does not now possess and intends to buy later.

As regards the two other contentions, that short selling does not perform an economic good, and that it actually depresses the prices of securities, these critics are in the wrong. The short seller in the stock market is often the greatest benefactor in repressing rampant speculative enthusiasm on the one hand, and in checking the effects on security prices of excessive pessimism on the other.

"Short sellers" do not determine prices. By selling they simply express their judgment as to what prices will be in the future. If their judgment is wrong they will suffer the penalty of being obliged to go into the market and buy the securities at higher prices. Nine-tenths of the people are by nature "bulls," and the higher prices go, the more optimistic and elated they become. If it were not for a group of "short sellers," who resist an excessive inflation, it would be much easier than now to raise prices through the roof; and then when the inflation became apparent to all, the descent would be abrupt and likely unchecked until the basement was reached. The operations of the "bear," however, make excessive inflation extremely expensive, and similarly tend to prevent a violent smash, because the "bear," to realize his profits, must become a buyer. The writer has been told by several members of the New York Stock Exchange that they have seen days of panic when practically the only buyers, who were taking the vast volume of securities dumped on the exchange, were those who had sold "short," and who now turned buyers as the only way of closing their transactions. They were curious to know what would have happened in those panic days, when everybody wished to sell and few cared to invest, if the buying power had depended solely upon the real investment demand of the outside public.

In reply also to the prevalent opinion that "short selling" unduly depresses security values, it should be stated that "short sellers" are frequently the most powerful support which the market possesses. It is an ordinary affair to read in the press that the market is sustained or "put up" at the expense of the "shorts" who, having contracted to deliver at a certain price can frequently easily be driven to "cover." Short selling is thus a beneficial factor in steadying prices and obviating extreme fluctuations. Largely through its action, the discounting of serious depressions does not take the form of a sudden shock or convulsion, but, instead, is spread out over a period of time, giving the actual holder of securities ample time to observe the situation and limit his loss before ruin results. In fact, there could be no organized market for securities, worthy of the name, if there did not exist two sides, the "bull' and the "bear." The constant contest between their judgments is sure to give a much saner and truer level of prices than could otherwise exist. "No other means," reports the Hughes' Committee, "of

restraining unwarranted marking up and down of prices has been suggested to us."

(4) It has long been recognized that the stock market exerts a powerful and wholesome influence upon the money market, and that the ownership by any country of a large mass of securities, which are listed on the leading exchanges, is a strong safeguard against financial panic. If confidence becomes shaken and a demand for money suddenly makes itself felt, causing creditors to insist on cash settlements, the banks are forced to call in loans and accumulate cash. But as pointed out before, stocks and bonds to an increasing extent serve as collateral for loans, and by virtue of the fact that such securities can be much more readily sold than other property, because of the continuous market for them, bankers first look toward the stock market for the application of corrective measures. The first blow, when money becomes dear, nearly always falls upon the stock market, that is to say, the first loans called are usually those protected with stock and bond collateral; and it frequently happens that a period of forced liquidation in this market sufficiently corrects the money situation so as to leave other business practically unmolested. Crises are prevented, when they can be thus prevented, through the liquidation of securities, and in case they cannot, the security market discounts them, and breaks their force into a succession of small declines, instead of a collapse. And even suppose the crisis is so far reaching that aid must be sought from abroad, if our bankers are the holders of many active stocks, listed on the foreign markets of England, France and Germany, their sale may be effected within an hour or two through a cable order, and the proceeds of the same at once forwarded to this country in the form of gold.

The extent to which credit is made available between different markets, all of which can be brought into touch with one another through the telegraph or cable, has been demonstrated by innumerable examples of the last few decades. The San Francisco conflagration, for example, involved an enormous waste of capital, which had to be replaced by underwriters within a short time; yet it is astonishing to observe how the domestic and foreign fire insurance companies were able to dispose of the securities, in which they had invested their funds, in order to supply the millions necessary to pay claims. Similarly, when France was called upon by

Germany to pay the enormous indemnity of one billion dollars at the close of the Franco-Prussian war, it was generally believed by all the world that France would be disastrously affected for decades to come. Yet the French were fortunately the owners of large masses of securities, many of them of international character and listed on the leading exchanges of the world. When, therefore, the French government called upon its citizens, in this time of distress, to buy government bonds, the quick response was most unexpected. The funds for the purchase of the bonds became readily available, because Frenchmen, being the owners of many securities, simply directed their brokers in London, Berlin, Paris, New York and other markets, to sell them. In brief, the titles which Frenchmen held to the debts of foreigners were simply transferred to other markets, and the proceeds obtained from the sale became available for the floating of the new French loan.

What may seem so apparent in the case of important crises, it should be remembered, occurs almost daily in a less sensational way. A corporation desires to borrow fifty million dollars, and the funds are readily obtained in the most available market by the sale of the securities, or by depositing them as security and borrowing thereon. From week to week the pressure on the money market is largely transferred to the borrower on call, who has deposited stocks and bonds as collateral; and frequent contraction or expansion in money rates is thus avoided. If there was not a large mass of salable securities, and large markets where they could be sold easily, we should have the spectacle of banks charging eight or nine per cent for time loans one month, and then two, three or four per cent another month. Since stock markets, however, make it possible for credit to be placed almost instantly at the disposal of one market or another where most needed, time loan rates fluctuate but little. Commercial borrowers continue to pay a rate of five or six per cent with the serene confidence that they need fear but little variation.

Another illustration of the facilities afforded by securities as a means of making payments, presents itself in the operations of foreign exchange, a field in which security markets are more and more playing an important part. If "A" in New York buys goods of "B" in London, the simplest way, apparently, for "A" to discharge his indebtedness, would be to ship gold to London. But the cost of transportation, handling and insurance, makes this the most

expensive means of effecting settlement. A cheaper plan would be to find a London merchant, "C," who owes money in New York, and request him to make payment in London to "A's" creditor; while "A" in New York makes payment to "C's" creditor in that city. This is the customary way of cancelling international debts, although the various parties interested do not themselves effect the cancellation, but request foreign exchange dealers to do this for them.

These foreign exchange dealers should always know which is the cheapest means of settling international debts, and right here it should be remembered that securities constitute, at times, the easiest and most profitable medium of payment. This brings up the subject of "arbitrage" in security markets, which will only be mentioned here to show the relation which the security market bears to the money market. It happens daily that the quotations for given stocks sold on the New York and London exchanges are not exactly the same, but for various reasons differ slightly. Furthermore, because of organized stock markets in which a market for active stocks is always assured, and the use of the cable, it is possible for an arbitrageur to buy a security in the low market and sell the same security in the other market, where it is selling higher, at almost the same time, and thus realize the difference. Hence the moment a security in London is higher than in New York, or *vice versa,* by a sufficient amount, a foreign exchange dealer in New York with stock exchange affiliations as an arbitrageur, who wishes to remit money to London, may sell that security in London, and at the same time buy that security in New York. Then, instead of sending the money to London, he may use the debt of the London purchaser of the security to settle the account for which he desired to remit the money; while, at the same time, he may pay for the securities he bought in New York with the money paid to him by the debtor in New York, who desired him to settle his account in London. Hence, by selling securites in London, and buying them in New York, or *vice versa,* international debts may be balanced without the transfer of any bullion. Such arbitraging, it is clear, must also tend to bring the prices of securities to a common level in all the leading stock markets of the world, so that an important stock will have a uniform price practically everywhere. The success of the method depends upon the arbitrageur's prompt knowledge of quotations in

the two markets. In practice such quotations are exchanged almost instantaneously. We are informed that the entire process of collecting quotations on the New York Exchange, cabling them across the ocean, and transacting a purchase or a sale on the London Exchange takes only a few minutes, and that some days no fewer than 5,000 messages are cabled by the large arbitrage houses for this purpose.

In the above arbitrage transaction, it is not even necessary to send the securities from one market to the other in order to close the account. Owing to the expense and inconvenience of shipping securities, arbitraguers, wherever possible, try to conduct their business in such a way as to make the shipping of securities between Europe and America unnecessary. As a matter of fact, very few such shipments are made. The arbitrageur, for example, may buy a certain quantity of stock in London to-day, selling the same stock in New York. The next trade, however, may represent a purchase of the same stock in New York, as against a sale in London. Assuming that 1,000 shares were involved in each transaction, the arbitrageur, since he has bought and sold 1,000 shares in each market, can simply balance the transactions and thus settle his entire account. But it is not even necessary for him to even up his daily accounts in order to avoid the shipment of securities. It may happen that he is obliged for a week, a month, or even longer, to continue purchasing a certain security in one market and selling it in another. Here he may do what the "short seller" does. In the market where he has sold the stock he can borrow the same in order to fulfil delivery, while in the market where he has continued to buy stock and it is accumulating on his hands, he may lend the stock for its market value. Thus he may borrow or lend in either market the securities involved in a series of unsettled transactions, and carry these transactions over an indefinite period to suit his convenience. He may continue this practice until a favorable opportunity presents itself for him to sell his accumulations of stock in one market and buy the same stocks in the other market. Most arbitrageurs will patiently await these opportunities from time to time, and the fewer the actual shipments made, the greater will be the profit.

The Curb Market

Aside from the transactions in stocks and bonds on the regularly organized stock exchanges of the world, a very considerable amount of buying and selling is done on the so-called "curb market," which may be defined as an open air market where all persons may buy and sell securities which are not listed on any organized exchange. Of such markets in America the New York "curb" is by far the most important, having had an existence of more than thirty years, although its real importance dates since 1897, when trading in unlisted securities began to assume tremendous proportions. In 1908 the recorded sales of bonds on this market aggregated sixty-six million dollars, and the industrial and mining shares sold there amounted to 46,495,000 in number.

According to the report of Governor Hughes' Committee on Speculation in Securities and Commodities, the New York curb depends, for most of its business, upon the members of the New York Stock Exchange, about eighty-five per cent of the orders emanating from stock exchange houses. In fact the New York Stock Exchange is largely responsible for the continued existence of the "curb," because of a provision in its constitution which prohibits its members either from becoming brokers of, or dealing on, any other organized exchange in New York. At present the "curb" market occupies a section of Broad Street, roped off for its special use, where from 150 to 200 brokers, and as many messenger boys and clerks, congregate daily during exchange hours, to transact orders in those securities which cannot be bought or sold on the regularly organized exchanges of the city.

The "curb" market is essentially an unorganized one, and the expenses of maintenance are met by voluntary subscription. Such regulations as exist are agreed to by common consent, and are promulgated by an agency, likewise established by common consent. This agency also issues daily the official quotations which appear in the public press. According to the report of the Hughes' Committee on Speculation, this agency consists "solely of an individual who, through his long association with the curb, is tacitly accepted as arbiter." There is nothing on the "curb" which can be compared to the method of listing stocks on a regular exchange, but corporations desiring to have their securities bought or sold

in that market must furnish the agency with certain limited information, which, however, is generally regarded as woefully incomplete and superficial. By way of comparison between the two methods of admitting securities to the two classes of markets, the committee reports that the listing committee of a regular exchange "while not guaranteeing the soundness of the securities, gives a *prima facie* character to those on the list, since the stock listing committee takes some pains to learn the truth. The decisions of the agent of the curb are based on insufficient data, and since much of the work relates to mining schemes in distant states and territories and foreign countries, the mere fact that a security is quoted on the curb should create no presumption in its favor; quotations frequently represent 'wash sales,' thus facilitating swindling enterprises."

Because of the unorganized character of the market, and the absence of the many disciplinary measures, already noted, which are imposed upon members of a regular exchange, it is only natural that many and bitter complaints should have been directed against the curb market. It is charged that many frauds are committed upon innocent and unsuspecting persons who, unacquainted with the practice of "washing" sales, are induced to buy and sell securities simply because they happen to be quoted on the "curb." Despite such abuses, however, resulting chiefly from the lax method of admitting securities and brokers to the market, it should be remembered that the curb list includes a larger number of very meritorious stocks, selling at very high quotations, which are dealt in on the curb simply because the corporations which they represent either do not desire to have them listed on regular exchanges or refuse to comply with the rules on listing of such exchanges, especially as regards the issuance of annual financial reports.

In view of the large amount of business on the "curb" which comes through the offices of stock exchange members, the Hughes' committee recommends that the stock exchange itself should formulate and enforce certain rules relative to the conduct of "curb" brokers, and the admission of securities to quotations. The committee recognizes the utility of a "curb" market, and in respect to stock exchange regulation of the same suggests that "if the curb brokers were notified that failure to comply with such requirements would be followed by an application of the rule of non-intercourse, there is little doubt that the orders of the exchange would be obeyed.

The existing connection of the exchange gives it ample power to accomplish this, and we do not suggest anything implying a more intimate connection. . . . To require an elaborate organization, similar to that existing in the exchanges, would result in the existence of another 'curb,' free from such restraints."